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# Recent Economic Developments in Iran

A Quarterly Report



No. 13 | January 2019

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## **Recent Economic Developments in Iran, A Quarterly Report** **No. 13, January 2019**

### **Economic Research Department, Middle East Bank**

Contributors: Farshid Eslambolchi, Mohammad Kousari, Hossein Soltanabadi, and Shamim Taheri

Graphic Designer: Hannaneh Niazmand

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## Notes

**Note 1:** In this Report the growth rate of a variable means the percentage change of that variable during the period under review, or at the point under discussion, compared to the similar period or point the preceding year. As such, “the growth rate of oil revenues in the first quarter of 1397” indicates the percentage change in oil revenues between the first quarter of 1396 and the first quarter of 1397.

**Note 2:** Iran follows the Persian Calendar, a solar calendar in which years start on the first day of spring and end on the last day of winter. The four quarters of the year correspond exactly to the four seasons. The current Persian year is 1397 that started on March 21, 2018, and ends on March 20, 2019. The Third quarter of 1397 (referred to as 1397Q3), fall of 1397, roughly corresponds to the Fourth quarter of 2018 in the Gregorian Calendar (2018Q4).

The following table provides an easy reference while reading this Report.

**1396Q3** = 09/23/2017 – 12/21/2017, roughly **2017Q4**

**1396Q4** = 12/22/2017 – 03/20/2018, roughly **2018Q1**

**1397Q1** = 03/21/2018 – 06/21/2018, roughly **2018Q2**

**1397Q2** = 06/22/2018 – 09/22/2018, roughly **2018Q3**

**1397Q3** = 09/23/2018 – 12/21/2018, roughly **2018Q4**

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## Iran's Economy at a Glance

	1396Q2	1396Q3	1396Q4	1396	1397Q1	1397Q2	1397Q3
<b>Labor Force Participation &amp; Unemployment Rates (percent)</b>							
Participation (10 Years and Over)	40.7	39.9	39.7	40.3	41.1	40.9	40.5
Unemployment (10 Years and Over)	11.5	11.7	12.1	12.1	12.1	12.2	11.7
Unemployment (Youth Aged 15-24)	26.9	28.3	29.2	28.4	28.3	27.2	27.0
<b>Real Growth Rates of GDP and Its Subsectors at Constant 1390 Prices (percent)*</b>							
Gross Domestic Product (GDP)	5.1	2.4	2.7	3.7	1.8	-1.1	-
Oil	5.7	-3.3	-4.2	0.9	5.2	0.6	-
Agriculture	3.3	4.0	2.1	3.2	0.3	-3.6	-
Manufacturing and Mining	5.5	4.5	5.5	5.1	0.1	-6.1	-
Services	4.8	4.0	4.4	4.4	1.1	1.2	-
Non-Oil GDP	4.9	4.2	4.8	4.6	0.7	-1.6	-
Gross Fixed Capital Formation (at market prices)	1.4	4.1	1.2	1.4	-0.8	-5.6	-
<b>Oil (daily average - thousand barrels)</b>							
Production	3,867	3,836	3,812	3,849	3,805	3,789**	-
Export	2,367	2,291	2,295	2,324	2,390	-	-
<b>Point-to-Point Inflation Rates (percent)</b>							
Growth Rate of Consumer Price Index (1395=100)	8.8	9.3	9.1	9.6	10.5	24.5	35.0***
Growth Rate of Producer Price Index (1395=100)	9.0	10.4	11.7	10.0	14.6	35.4	58.7
<b>Balance of Payments (USD millions)</b>							
Oil Exports	15,736	16,468	19,448	65,818	20,980	-	-
Non-Oil Exports	7,200	8,332	9,616	32,324	8,356	-	-
Import of Goods	17,269	19,158	22,836	75,546	16,353	-	-
Goods Account (Net)	5,667	5,643	6,227	22,596	12,983	-	-
Non-Oil Goods Account (Net)	-9,708	-10,039	-11,897	-40,458	-7,330	-	-
Current Account	3,718	3,473	4,902	15,816	11,061	-	-
Capital Account	-4,956	-5,499	-7,528	-19,321	-5,263	-	-
Change in Foreign Reserves	-3,968	-3,078	491	-8,140	3,933	-	-
<b>Foreign Exchange Rates (USD/IRR daily average)</b>							
In Free Market****	38,236	40,719	45,548	40,552	60,365	103,721	133,700
Official Rate	32,900	34,800	36,842	34,276	41,392	42,646	42,000
<b>Monetary and Credit Aggregates (end of period - IRR trillions)</b>							
Monetary Base (M0)	1,964.9	1,995.0	2,139.8	2,139.8	2,186.6	2,365.5	-
Central Bank Claims on Banks	1,097.1	1,130.7	1,320.3	1,320.3	1,397.1	1,506.5	-
Central Bank Claims on Public Sector (Net)	292.2	279.9	55.1	55.1	82.8	82.4	-
Liquidity (M2)	13,899.5	14,453.1	15,299.8	15,299.8	15,827.5	16,723.7	-
Money (M1)	1,682.4	1,737.4	1,946.7	1,946.7	2,059.5	2,436.7	-
Sight Deposits	1,337.7	1,385.8	1,504.0	1,504.0	1,635.5	1,991.7	-
Non-Sight Deposits (Quasi-Money)	12,217.1	12,715.7	13,353.1	13,353.1	13,768.0	14,287.0	-
<b>Government Budget and Fiscal Position (IRR trillions)</b>							
Total Revenues	590.5	579.2	1,002.7	2,598.5	590.6	676.1	-
Tax Revenues	249.3	252.6	474.6	1,158.4	225.9	277.5	-
Oil Revenues	257.8	193.0	279.6	919.2	326.0	304.6	-
Other Revenues	83.5	133.6	248.5	520.9	38.7	94.0	-
Total Expenditures*****	596.9	783.4	887.4	2,868.6	880.7	758.3	-
Current Expenditures	526.1	560.3	794.2	2,429.4	588.1	721.8	-
Development Expenditures	70.0	224.0	137.0	439.2	226.7	39.7	-
Budget Balance	-6.4	-204.3	115.3	-270.1	-290.1	-82.2	-
<b>Tehran Stock Exchange (end of period)</b>							
Overall Index (TEDPIX)	85,832	95,509	96,290	96,290	108,873	160,538	156,083
Financial Index	129,604	134,057	119,176	119,176	120,837	165,359	172,718
Industrial Index	74,823	74,078	86,082	86,082	98,476	146,264	141,206
Market Capitalization (IRR trillions)	3,396	3,946	3,847	3,847	4,213	6,124	5,924

Source: Central Bank of the Islamic Republic of Iran (CBI) and Statistical Centre of Iran (SCI), various reports

\* Based on CBI reports at basic prices. The figures for 1397Q2 are based on SCI report and are not comparable with other figures.

\*\* According to OPEC reports from direct sources

\*\*\* Based on SCI report and incomparable with other figures which are based on CBI reports

\*\*\*\* Since 21/01/1397, the free market USD/IRR exchange rate has been considered based on Tehran's black market.

\*\*\*\*\* The difference between the data on sum of current and development expenditures and total expenditures in a given quarter is due to the fact that revolving funds are not settled in each quarter but only at the end of the year.

## 1. Real Sector

According to the preliminary estimates of the Statistical Center of Iran (SCI), the economic growth rate dropped to a mere 0.4 percent and the non-oil growth rate dipped to merely 0.3 percent in the first half of 1397 (1397H1). During this period, the whole value added of economic activities accounted for IRR10,987 trillion at current prices, 18.4 percent of which pertained to the extraction of oil and natural gas subsector. This sector registered 0.8 percent real growth rate, which is rather negligible in comparison with the corresponding figures in its preceding two years and is expected to decrease more over 1397H2. Among all sub-sectors of industry, the “extraction of oil and natural gas” and “other mines” were the only subsectors

with positive real growth rates and all others contracted during this period, compared to 1396H1. The second quarter of 1397 (1397Q2) underwent harsher conditions in terms of economic growth and played a central role in registering negative rates for sectors such as agriculture, construction and manufacturing. The services sector was the only one that witnessed positive real growth rates in the first two quarters of 1397 (3.4 percent and 1.2 percent, respectively) and constituted a significant share in the positive growth rate of the whole economy. Table 1 demonstrates quarterly real growth rates of GDP as well as its subsectors, over 1396 and the first half of 1397.

Table 1- Growth Rates of GDP and Its Subsectors at Constant 1390 Prices (percent)

	1396						1397		
	Q1	Q2	H1	Q3	Q4	Year	Q1	Q2	H1
<b>Industry</b>	<b>4.5</b>	<b>5.9</b>	<b>5.2</b>	<b>0.8</b>	<b>-2.8</b>	<b>2.0</b>	<b>0.4</b>	<b>-2.8</b>	<b>-1.2</b>
Manufacturing	6.5	2.3	4.3	3.6	2.3	3.6	1.1	-3.0	-2.1
Mining	4.5	3.8	4.1	1.8	-3.8	1.6	1.0	0.8	0.9
Extraction of Oil and Natural Gas	4.7	4.0	4.3	1.6	-4.2	1.5	1.0	0.6	0.8
Other Mines	1.1	1.5	1.3	5.0	3.5	2.8	2.5	3.3	2.9
Water, Gas, and Electricity Supply	1.9	22.7	11.8	-8.7	-8.1	0.2	1.8	-12.1	-5.5
Construction	3.1	4.8	4.0	8.2	-1.8	3.2	-1.0	-8.0	-4.8
<b>Agriculture</b>	<b>2.9</b>	<b>-0.6</b>	<b>0.7</b>	<b>1.0</b>	<b>1.9</b>	<b>1.0</b>	<b>-0.8</b>	<b>-3.6</b>	<b>-2.5</b>
<b>Services</b>	<b>7.5</b>	<b>6.8</b>	<b>7.1</b>	<b>7.0</b>	<b>6.1</b>	<b>6.8</b>	<b>3.4</b>	<b>1.2</b>	<b>2.3</b>
<b>Non-oil Gross Domestic Product</b>	<b>6.0</b>	<b>5.5</b>	<b>5.8</b>	<b>4.1</b>	<b>2.9</b>	<b>4.6</b>	<b>2.3</b>	<b>-1.6</b>	<b>0.3</b>
<b>Gross Domestic Product</b>	<b>5.7</b>	<b>5.2</b>	<b>5.4</b>	<b>3.6</b>	<b>1.4</b>	<b>3.9</b>	<b>2.0</b>	<b>-1.1</b>	<b>0.4</b>

Source: Statistical Center of Iran, Report of National Accounts

On the demand side, private consumption that made up 50.3 percent of GDP, contracted and this implied a decline in the welfare of Iranians in 1397Q2. However, its six-month growth rate was positive (1.6 percent), which is by far less than the rates registered in the two former years. The other worrying fact is the negative real growth rate of gross fixed capital formation, which was intense in construction relative to machinery. On the other

hand, government consumption expenditures rose by 5.9 percent and net export of goods and services increased by 4.1 percent at constant prices. The depreciation of Iranian rial against US dollar was the most compelling reason of the drop in imports and one of the contributors to a minimal rise in exports. Table 2 presents these data more precisely.

Table 2- Growth Rates of GDP's Components on the Expenditures Side at Constant 1390 Prices (percent)

	1396						1397		
	Q1	Q2	H1	Q3	Q4	Year	Q1	Q2	H1
<b>Private Consumption</b>	<b>7.6</b>	<b>7.8</b>	<b>7.2</b>	<b>7.6</b>	<b>5.7</b>	<b>7.2</b>	<b>4.1</b>	<b>-0.7</b>	<b>1.6</b>
<b>Government Consumption</b>	<b>7.4</b>	<b>7.4</b>	<b>7.4</b>	<b>7.4</b>	<b>7.4</b>	<b>7.4</b>	<b>5.9</b>	<b>5.9</b>	<b>5.9</b>
<b>Gross Fixed Capital Formation</b>	<b>4.8</b>	<b>3.9</b>	<b>3.4</b>	<b>4.8</b>	<b>0.4</b>	<b>3.4</b>	<b>0.3</b>	<b>-5.6</b>	<b>-2.7</b>
Machinery	6.0	2.9	3.6	2.2	3.2	3.6	1.6	-2.6	-0.4
Construction	3.5	4.8	3.2	8.0	-2.0	3.2	-1.1	-8.0	-4.8
<b>Net Export of Goods and Services</b>	<b>-7.6</b>	<b>-1.1</b>	<b>-8.4</b>	<b>-15.4</b>	<b>-9.5</b>	<b>-8.4</b>	<b>7.9</b>	<b>0.7</b>	<b>4.1</b>
Export of Goods and Services	-3.1	0.9	-3.6	-10.5	-1.4	-3.6	7.2	-4.8	1.0
Import of Goods and Services	13.5	9.9	13.4	3.9	27.0	13.4	5.2	-27.1	-9.6
<b>Gross Domestic Expenditure</b>	<b>5.7</b>	<b>5.2</b>	<b>3.9</b>	<b>3.6</b>	<b>1.4</b>	<b>3.9</b>	<b>2.0</b>	<b>-1.1</b>	<b>0.4</b>

Source: Statistical Center of Iran, Report of National Accounts

The Research Center of the Islamic Parliament estimated a negative economic growth rate for both 1397 and 1398, expecting a recession in the current and forthcoming years. According to

this estimate, the economy will contract between 2.6 percent and 5.5 percent in 1397 and will shrink by 4.5 percent to 5.5 percent in the next year.

## Energy

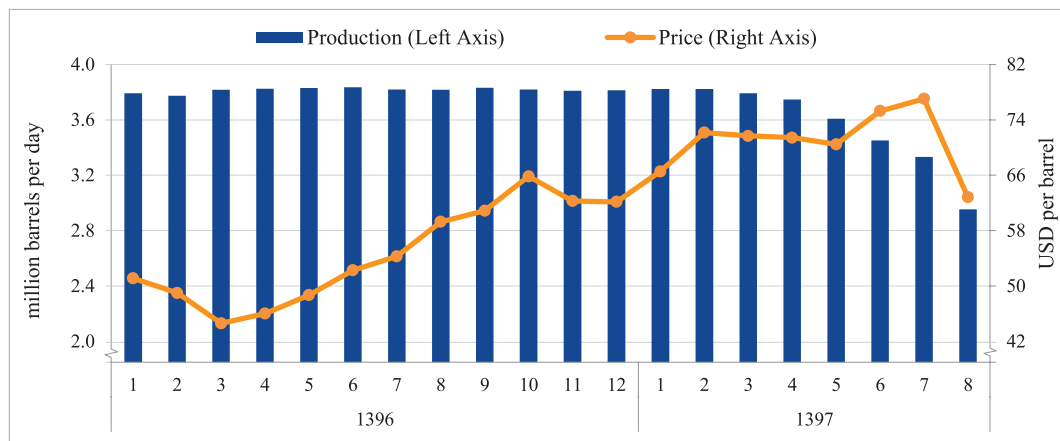
The recent downward trend of Iranian crude oil production, which commenced in 03/1397 and intensified since 05/1397, was mainly due to the revival of US sanctions. This may account for the fact that no official data on the oil production have been published since the beginning of fall 1397. According to the most recent OPEC report which cites secondary sources<sup>1</sup>, Iran's average daily crude oil production stood at approximately 2.9 million barrels in November 2018 (almost 08/1397), 379 thousand barrels below the corresponding figure a month earlier and 869 thousand barrels below that of 01/1397. This was the lowest level of Iranian oil production recorded during the last 22 months.

The above mentioned considerable reduction in oil production laid the groundwork for the exemption of Iran from farther cutback on which OPEC member countries had recently agreed upon. In December 2018, oil-exporting countries including OPEC members and non-members, came to an arrangement for reducing daily oil production in two stages by 800 thousand barrels and 400 thousand barrels. Iran, Venezuela, and Libya were the only countries whose production was not affected by this agreement. As a result, the international oil prices rose to

some extent, albeit temporarily. Notwithstanding the OPEC agreement that led the oil prices to hit the peak of USD85 per barrel in early October, the average price plummeted to a low of USD54 at the end of 2018.<sup>2</sup> By the same taken after recording USD77 per barrel in 07/1397, the average price of Iranian heavy oil slipped back to USD63.8 in 08/1397 and is estimated to reach around USD50 in 10/1397. Figure 1 compares average daily production and average price of heavy Iranian oil in 1396 and the first eight months of 1397.

The official statistics of Iranian oil exports have not been released in recent months. However, unofficial sources report a steady downward trend. In November 2018, among the main Asian customers of Iranian oil, South Korea and Japan did not purchase any for the third consecutive month. Moreover, China and India decreased their imports by at least 13 percent compared to the same month the preceding year. The USA, however, granted waivers to eight major Iranian oil importers and requested a gradual decrease in their oil purchase from Iran. This exemption will probably lead to another temporary rise in the official statistics of Iranian oil exports.

Figure 1- Iran's Average Daily Crude Oil Production and Average Price of Iran's Heavy Oil\*



Source: OPEC Monthly Reports, Based on Secondary Sources

\*OPEC statistics are based on Gregorian calendar years and their conversion into Persian calendar years are only approximate.

## Housing

Among housing market business cycles, the first nine months of 1397 must be considered as an absolute boom, usually recognized by a leap in prices and a high level of transactions. Since the beginning of 1397, the price of residential units has increased noticeably (from 5 percent to 10 percent, monthly) and hit a peak of IRR95 million per square meter in 09/1397, accounting for an erratic growth rate of 91.8 percent in comparison to the same month the year before. As expected, this surge in prices eventually resulted in a marked reduction in the purchasing power of consumers and led to a gradual

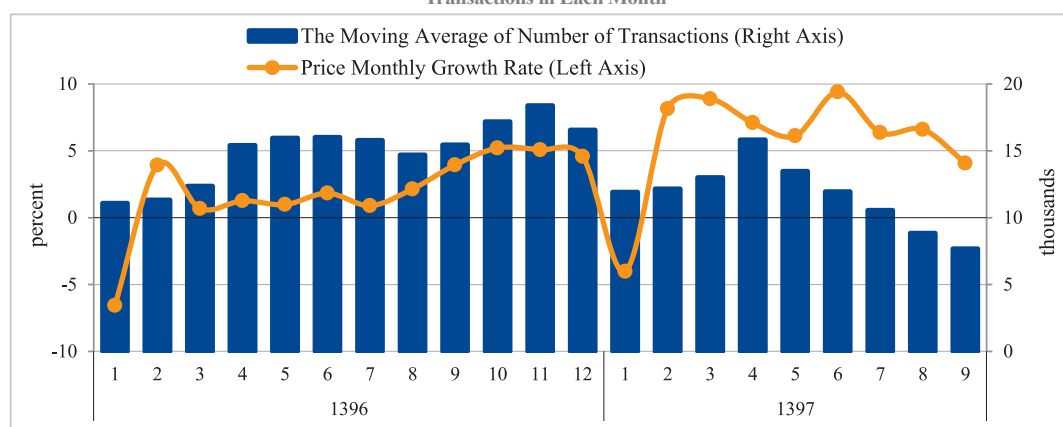
decline in the number of deals.

The number of transactions, which reached well over 19 thousand in 02/1397, bounced back to 10.3 thousand and 6.8 thousand in 06/1397 and 09/1397, respectively. The latter is almost equal to the level recorded in 05/1392, the lowest amount of transactions from the beginning of the 1390s and served as a signal for the subsequent recession. Figure 2 depicts the movement of housing price growth rate and the number of transactions.

1. OPEC consults two sources to publish the data on oil production for different countries: direct sources published officially by each country and secondary sources that consist of different unofficial international reports.

2. <https://www.quandl.com/data/OPEC/ORB-OPEC-Crude-Oil-Price>

Figure 2- The Monthly Growth Rate of Average Housing Price and the Moving Average of the Number of Registered Transactions in Each Month



Source: Central Bank of Iran, Developments in Housing Market in Tehran, various issues

The pattern of housing deals in terms of size implies that homebuyers in Tehran increasingly favored smaller units as their purchasing power has been deteriorated. In 09/1397, 61.1 percent of sold units measured between 40 and 90 square meters and valued between IRR1,500 million and IRR7,500 million. In addition, the number of residential units aged

less than five years made up the majority of the volume of transactions with 43.4 percent and dropped by 5.4 percentage points compared to the corresponding month of a year earlier. On the other hand, the proportion of other transacted houses, specifically aged between 16 and 20 years, rose moderately.

## Labor Force

According to the latest labor market report published by the SCI, economic participation rate rose by 0.4 percentage points to 40.5 percent and the unemployment rate remained almost unchanged on 11.7 percent in 1397Q3 compared to fall 1396. Since 1393Q3, the quarterly economic participation rate has continuously increased, as well as the unemployment rate that has only witnessed four quarters of a slight reduction from 1396Q2 to 1397Q1, compared to the same quarter year ago. During this period, nearly one-fourth of the population aged

15-29 who were both able and willing to be engaged in a job could not find any, so that the unemployment rate for this age group was quite considerable, registering roughly 25 percent. Besides, between 9 percent and 11 percent of the employed were underemployed, working less than 44 working hours per week in spite of their ability and willingness to work more. Table 3 presents some of the most important indices of labor market from 1396Q1.

Table 3- Labor Market Indices for the Population Aged 10 and over (percent)

	1396					1397		
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Economic Participation Rate (percent)	40.6	40.7	39.9	39.7	40.3	41.1	40.9	40.5
Unemployment Rate (percent)	12.6	11.5	11.7	12.1	12.1	12.1	12.2	11.7
Unemployment Rate for the Population Aged 15-29 (percent)	26.4	24.1	25.0	25.2	25.3	25.5	24.9	24.5
Share of the Underemployed (percent)	10.2	9.2	11.0	11.5	10.4	10.2	10.0	11.7

Source: Statistical Center of Iran, Summary Results of the Labor Force Survey, various issues

The detailed statistics in 1397Q2 show that the unemployment rate among highly educated individuals was greater than the average rate and recorded 18.7 percent. Women comprised 52.5 percent of the highly educated unemployed, 32.3 percent of the whole unemployed and merely 18.1 percent of the employed, which indicates their low economic participation rate.

Regarding the sectoral distribution of the employed, around half of them belong to the services sector and one-third are engaged in the manufacturing sector (including oil and gas). Meanwhile, the share of private sector in the employed population was 84.7 percent (86.3 percent for men and 77.5 percent for women). These statistics are represented more precisely in Table 4.

Table 4- Some Detailed Indices of Iranian Labor Market for Men and Women in 1397Q2

	Total	Men	Women
Number of the Unemployed (1000 people)	3,326.9	2,251.7	1,075.1
Share (percent)	100.0	67.7	32.3
Number of the Highly Educated Unemployed (1000 people)	1,314.1	623.7	690.2
Share (percent)	100.0	47.5	52.5
Number of the Employed (1000 people)	23,955.7	19,613.7	4,341.9
Share (percent)	100.0	81.9	18.1
Share of the Employed in Sectors (percent)			
Agriculture	18.9	18.3	22.0
Industry	31.6	33.0	25.2
Services	49.5	48.8	52.8
Share of the Employed in Sectors (percent)			
Private	84.7	86.3	77.5
Public	15.3	13.7	22.5

Source: Statistical Center of Iran, Summary Results of the Labor Force Survey, various issues

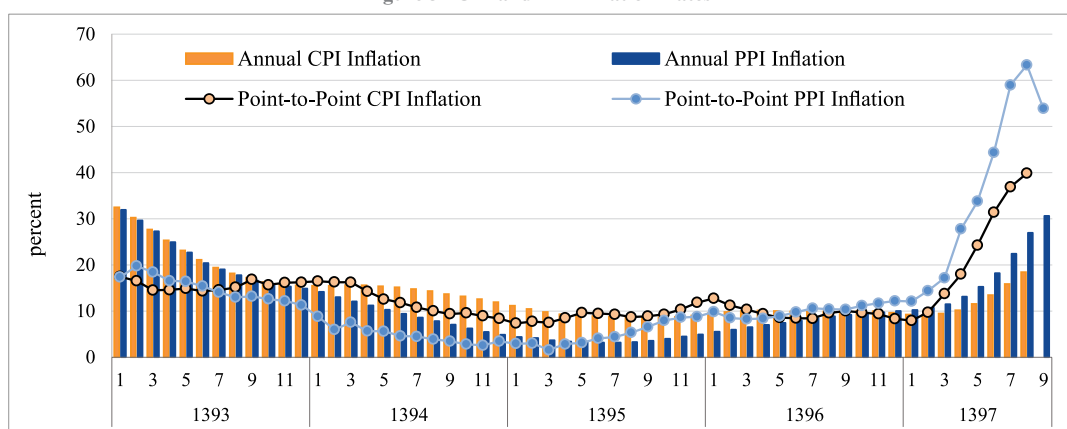
## 2. Prices and Inflation

The steady consumer price index (CPI) inflation rate, considered as a precious achievement of the current government by almost the end of 1396, has been threatened since around the beginning of 1397Q2. The point-to-point inflation rate which had been leveling out below 10 percent for 11 subsequent months since 04/1396, escalated to 13.7 percent in 03/1397 and soared to 39.9 percent in 08/1397; the highest amount from 07/1392. The annual average inflation rate, consequently, hit a high of 18.4 percent which was unexampled for about four years. This may be the main rationale according to which the CBI ceased to release the data for the CPI inflation rate in 09/1397, after publishing it continuously for a couple of decades. The SCI, which usually computes the inflation rates lower than the rate reported by the CBI, announced the annual CPI inflation rate at 18.0 percent

and the point-to-point CPI inflation rate at 37.4 percent for 09/1397.

The producer price index (PPI) experienced more or less the same pattern as the CPI, albeit having a slight time lead over that. The point-to-point PPI inflation rate, which had been lower than CPI inflation rate since 07/1393, overtook it in 05/1396 and climbed sharply to its peak over the last decade (63.3 percent) in 08/1397. The average annual PPI inflation rate, also, soared to 26.9 percent, much higher than that of CPI. Given the lagged effect of the former on the latter and considering the wide gap between them, the CPI inflation rate is bound to continue its noticeable upward trend in the forthcoming months. Figure 3 exhibits the monthly inflation rates of CPI and PPI from the year 1393.

Figure 3- CPI and PPI Inflation Rates



Source: Central Bank of Iran, reports of consumer price index, various issues

The CBI categorizes goods and services in 12 major groups whose weights are determined through households' expenditures surveys in the base year. Among these groups, "tobacco" registered by far the highest point-to-point inflation rate (150.8 percent), whereas "housing, water, electricity, gas, and other fuels" recorded the lowest figure (14.5 percent) in 08/1397. Besides, "recreation and culture", "equipment and routine services at homes", and "foods and beverages" ranked

second to fourth, with 86.5 percent, 83.1 percent, and 59.9 percent, respectively. According to other classifications of CBI's reports in 08/1397, the price index of "goods" rocketed by 61.9 percent and that of "services" escalated by 19.3 percent. In addition, the price index of "tradable" and "non-tradable" goods and services marked growth rates of 66.4 percent and 19.1 percent, in that order.

The CBI has recently reported the detailed inflation statistics



based on different expenditure deciles. Since the share of each goods-and-services group in the consumption basket of different deciles varies considerably, the distinct effect of inflation on their expenditures is also reasonable. On this basis, the first decile experienced the lowest CPI inflation rate (29.9 percent), while the tenth decile underwent the highest rate (49.1 percent). This seems consistent with other data published by the CBI, as the proportion of low-inflated groups like housing, education, and health are greater in the

expenditures basket of low-income households. However, it does not imply that those in the first decile suffered less than their wealthy counterparts. Admittedly, due to the lower consumption-to-income ratio as well as the higher saving-to-income ratio for well-to-do households compared to those in the first decile, the impact of inflated prices could be more significant for the latter. Table 5 represents the point-to-point inflation rates based on different expenditure deciles.

Table 5- Point-to-Point Inflation Rates in Urban Areas, Based on Different Expenditure Deciles in 1397 (percent)

	1 <sup>st</sup>	2 <sup>nd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>	5 <sup>th</sup>	6 <sup>th</sup>	7 <sup>th</sup>	8 <sup>th</sup>	9 <sup>th</sup>	10 <sup>th</sup>	Total
01/1397	7.4	7.4	7.2	7.2	7.1	7.3	7.3	7.2	7.7	8.7	7.9
02/1397	8.4	8.3	8.5	8.7	8.6	8.9	9.1	9.0	9.9	11.2	9.7
03/1397	11.7	12.5	12.8	12.7	12.9	13.0	13.2	13.1	13.8	15.7	13.7
04/1397	14.6	15.8	16.5	16.4	16.6	16.8	17.1	17.3	17.8	20.9	18.0
05/1397	18.7	20.3	21.3	21.5	21.9	22.4	22.9	23.3	24.7	29.4	24.2
06/1397	23.2	25.3	26.8	27.3	28.1	28.7	29.6	30.3	33.1	40.3	31.4
07/1397	27.6	30.2	32.0	32.7	33.6	34.4	35.6	36.0	39.1	46.0	36.9
08/1397	29.9	32.5	34.5	35.6	36.5	37.6	38.6	39.3	42.5	49.1	39.9

Source: Central Bank of Iran, Consumer Price Index Report based on Expenditure Deciles, 08/1397

### 3. Balance of Payments

At the time of finalizing this report, the latest published data for balance of payments by the CBI pertain to 1397Q1. According to this data, the overall balance which is calculated as the sum of net current account, capital account and errors and omissions, amounted to USD3.9 billion in 1397Q1. However, the corresponding figure for 1396Q1 was negative USD1.6 billion. Reviewing the details reveals that current account surplus increased by 197.1 percent to reach USD11.1 billion, while the net capital account deficit rose by 293.2 percent and registered USD5.3 billion. Furthermore, errors and omissions declined from negative USD4.0 billion in 1396Q1 to negative USD1.9 billion in 1397Q1. In conclusion, considerable rise in current account surplus was the main contributor to the rise of overall balance in 1397Q1 compared to 1396Q1, despite the growth in the capital account deficit - which indicates that capital outflow exceeded capital inflow.

Current account is composed of goods account, services account, income account, and current transfers account. The balance of payments data show that goods account, which is the difference between goods exports and goods imports, rose considerably by

156.6 percent to reach USD13.0 billion in 1397Q1. Although the value of imported goods rose by 0.4 percent to reach USD16.4 billion, the significant rise in exported goods by 37.5 percent, which stood at USD29.3 billion, was the major factor of goods account growth. The growth in goods exports was mainly due to the increase in oil exports by 48.1 percent to USD21.0 billion, while the rise of non-oil exports by 16.5 percent to USD8.4 billion was not that significant. On the other hand, oil imports grew by 127.7 percent and amounted to USD666 million. Meanwhile, non-oil imports declined by 1.9 percent and hit USD15.7 billion. Therefore, the oil trade balance surplus rose by 46.4 percent and reached USD20.3 billion, while the non-oil trade balance deficit fell by 16.8 percent and amounted to USD7.3 billion in 1397Q1. In the quarter under review, the services account deficit increased by 32.9 percent and registered USD2.3 billion, which indicates that the rise in services imports exceeded that of services exports. Finally, income account and current transfers account decreased by 20.3 percent and increased by 26.5 percent, respectively, compared to the first quarter of the previous year. Table 6 presents the components of balance of payments in the first quarters of 1395-97.

Table 6- Components of Balance of Payments (USD millions)

	1395Q1	1396Q1	1397Q1	Percentage Change of 1396 to 1395	Percentage Change of 1397 to 1396
Current Account	5,231	3,723	11,061	-28.8	197.1
Goods Account	6,522	5,059	12,983	-22.4	156.6
Exports (FOB)	18,905	21,342	29,336	12.9	37.5
Oil	11,640	14,166	20,980	21.7	48.1
Non-Oil	7,264	7,176	8,356	-1.2	16.4
Imports (FOB)	12,383	16,283	16,353	31.5	0.4
Gas and Oil Products	301	293	666	-2.7	127.3
Others	12,081	15,990	15,686	32.4	-1.9
Services Account	-1,610	-1,713	-2,276	6.4	32.9
Income Account	198	263	210	32.8	-20.2
Current Transfers Account	121	114	144	-5.8	26.3
Net Capital Account	-5,022	-1,338	-5,263	-73.4	293.3
Errors and Omissions	-6,380	-3,970	-1,865	-37.8	-53.0
<b>Overall Balance</b>	<b>-6,171</b>	<b>-1,585</b>	<b>3,933</b>	<b>-74.3</b>	<b>-348.1</b>

Source: Central Bank of Iran, Selected Economic Indicators, various issues

According to the latest report of the Ministry of Industry, Mine and Trade, the value of goods imported to the country in 1397H1 amounted to USD21.1 billion which indicates 14.1 percent decline compared to 1396H1. Also, goods imports in terms of weight decreased by 13.8 percent in the period under review. The value share of imported capital goods, consumption goods, and intermediate goods were 16.0 percent, 17.5 percent, and 66.4 percent, respectively, indicating lower shares of capital goods and consumption goods and higher share of intermediate goods compared to the same period of the previous year. However, the ratio of value to weight (unit price) for imported capital goods rose significantly, while the corresponding ratio for consumption goods declined and that of intermediate goods increased slightly. The largest drop in the value of imports was recognizable in the category of consumption goods followed by capital goods, while the highest decrease in imports in terms of weight was attributable to capital goods followed by consumption goods.

On the other hand, the value of exports totaled USD23.1 billion in the period under review which shows 12.1 percent growth. However, the total exports in terms of weight declined by 4.0 percent. The value share of exported capital goods, consumption goods, and intermediate goods amounted to 2.2 percent, 16.9 percent, and 80.9 percent, respectively, indicating higher shares of capital and consumption goods and lower share of intermediate goods compared to the same period of the previous year. The highest rise in exports, both in terms of value and weight, was associated with capital goods followed by consumption goods. However, the export of intermediate goods increased in terms of value but decreased in terms of weight. The ratio of value to weight (unit price) of exported capital goods rose significantly, while the corresponding ratio for consumption goods declined and that of intermediate goods increased slightly. Table 7 depicts the details of trade in different categories of goods in the first half of 1396 and 1397.

Table 7- Details of Trade in Different Categories of Goods in 1396H1 and 1397H1

	1396H1			1397H1			Percentage Change		
	Weight (thousand tons)	Value (USD millions)	Value Share (percent)	Weight (thousand tons)	Value (USD millions)	Value Share (percent)	Weight	Value	
Imports	Capital Goods	413.9	4,132.2	16.8	286.3	3,388.1	16.0	-30.8	-18.0
	Consumption Goods	2,134.1	5,332.1	21.7	1,572.8	3,703.3	17.5	-26.3	-30.5
	Intermediate Goods	14,500.5	15,112.0	61.5	12,834.6	14,018.5	66.4	-11.5	-7.2
	<b>Total</b>	<b>17,048.5</b>	<b>24,576.3</b>	<b>100.0</b>	<b>14,693.7</b>	<b>21,109.9</b>	<b>100.0</b>	<b>-13.8</b>	<b>-14.1</b>
Exports	Capital Goods	41.2	179.9	0.9	62.7	503.9	2.2	52.2	180.1
	Consumption Goods	2,686.5	3,149.7	15.3	3,445.5	3,917.0	16.9	28.3	24.4
	Intermediate Goods	56,293.5	17,298.8	83.9	53,134.7	18,693.9	80.9	-5.6	8.1
	<b>Total</b>	<b>59,021.2</b>	<b>20,628.4</b>	<b>100.0</b>	<b>56,642.9</b>	<b>23,114.8</b>	<b>100.0</b>	<b>-4.0</b>	<b>12.1</b>

Source: The Ministry of Industry, Mine and Trade; preliminary report of 1397H1 performance

Based on the latest report of the Islamic Republic of Iran Customs Administration, imports registered 23.8 million tons, valued at USD32.6 billion and exports reached 86.9 million tons, valued at USD33.4 billion, in the first nine months of 1397. Imports declined by 13.3 percent and 15.9 percent in terms of weight and value, compared to the same period of 1396, respectively. Meanwhile, exports increased by 5.4 percent and decreased by 2.0 percent in terms of value

and weight, in that order. Therefore, USD7.1 billion non-oil trade balance deficit in the first nine months of 1396 gave place to USD738 million surplus in the same period of 1397.

According to the aforementioned report, the exports of petrochemicals reached 27.9 million tons, valued at USD11.5 billion, showing 32.9 percent and 31.2 percent growth in terms of weight and value, respectively, compared to the first nine months of 1396. However, the exports of natural gas

condensates registered 5.3 million tons, valued at USD2.7 billion, which indicates 58.6 percent and 45.1 percent drop in weight and value, in that order, compared to the same period of the year earlier. In the period under review, the main exported items in terms of value were natural gas condensates valued at USD2.8 billion, liquified natural gas at USD1.8 billion, liquified propane at USD1.4 billion, methanol at USD1.1 billion, and light crude oil except gasoline at USD1.1 billion. Moreover, while China was the biggest importer of Iranian goods in the first nine months of 1396, valued at USD6.3 billion, Iraq ousted China from this position by imports reaching USD6.9 billion with the value share of 20.8 percent in the same period of 1397. Additionally, the UAE, Afghanistan, and Turkey imported USD5.1 billion, USD2.3 billion, and USD1.9 billion from Iran, respectively, to secure next places in the ranking of the largest importers of Iranian goods in the first nine months of 1397.

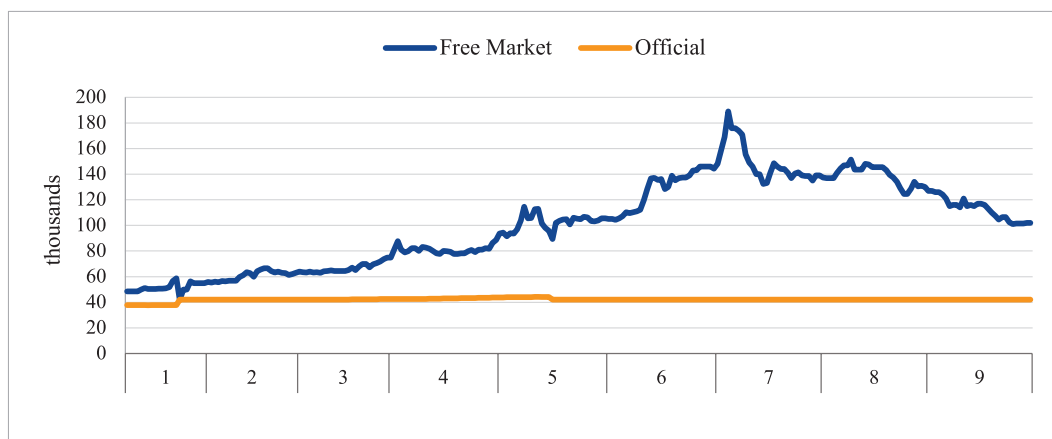
#### 4. Foreign Exchange Market

The Iranian Rial (IRR) recorded its highest depreciation at the beginning of fall 1397. The USD/IRR free market exchange rate which had reached 50,000 at the beginning of 1397, almost tripled at the end of summer and passed 190,000 at the beginning of fall, but it reversed course and started a downward trend to reach 100,000 at the end of this quarter.

On the other hand, cattle feed corn valued at USD1.5 billion, auto parts at USD1.2 billion, rice at USD1.0 billion, soybean at USD944 million, and charcoal electrodes at USD437 million were the main imported items, in that order. China with exports valued at USD8.2 billion, which constituted 25.1 percent of total Iran's imports, was the biggest exporter to the country in the first nine months of 1397. While imports from China declined by 11.6 percent in terms of value, the value share of these imported items rose by 1.2 percentage points. Furthermore, the value of imports from the UAE, South Korea, and Germany which were the next largest exporters to Iran during this period, decreased by 29.0 percent, 32.7 percent, and 14.1 percent, respectively, compared to the first nine months of 1396. However, imports from Switzerland increased by 3.6 percent and 10.5 percent in terms of weight and value, respectively, to reach 3.5 million tons and USD1.8 billion. This country took the fifth place in the list of the biggest exporters to Iran in the first nine months of 1397.

In 1397Q3, the average USD/IRR exchange rate grew by 28.9 percent compared to 1397Q2 and by 228.3 percent compared to 1396Q3. Figure 4 depicts the daily USD/IRR exchange rates during the first nine months of 1397 in both official and free markets.

Figure 4- Daily USD/IRR Exchange Rates in the Free Market and the Official Market in the First Nine Months of 1397



Source: Central Bank of Iran; Financial Informing Network; Other unofficial sources

Following the emphasis of the policy-maker on keeping the official exchange rate of USD/IRR at 42,000 for essential goods and medicine imports, the gap between the official rate and the free market rate widened, which translated to more opportunities for economic rent and corruption. This gap which stood at 32.4 percent at the beginning of spring reached 319.0 percent at the beginning of fall. In 1397Q3, the average exchange rate of USD/IRR in the free market was 218.3 percent higher than that in the official market. However, the foreign exchange policy is not limited to setting the rates in these two markets. The NIMA system (Integrated Foreign Exchange Trading System) offers another rate between these two rates. The non-oil exporters' foreign exchange commitment is supposed to provide currency supply in NIMA and the demand is limited to selected items by discretion of the policy-maker. Regardless of the policy-

maker interventions in this market which provide opportunity for economic rent, the frequent changes in the list of aforementioned selected items have been one of the sources of instability in the Iranian economy.

Another important development of the foreign exchange market in 1397Q3 was the issuance of a circular on the return of foreign exchanges from exports. In this circular, all exporters were required to return the foreign exchanges from exports, although they were divided into four different categories in terms of the foreign exchange commitment details. Exporters who exported less than 1 million euros a year were exempted from the return of export proceeds to NIMA and were allowed to use them for imports finance or sell them to banks and authorized currency exchanges. Exporters who exported between 1 and 3 million euros a year were obliged

to sell 50 percent of their earnings in foreign exchanges from exports in NIMA. This figure for those who exported 3-10 million euros a year was 70 percent and for those with more than 10 million euros a year was 90 percent. Regardless of the implications of foreign exchange commitment and the motivation for manipulation of accounts or the formation of small subsidiary companies, this circular led to re-export of the imports which were financed by NIMA.

## 5. Monetary and Credit Aggregates

In 07/1397, CBI net foreign assets, its claims on banks, and net other items increased by 23.0 percent, 42.8 percent, and 23.2 percent, respectively, while its net claims on public sector fell by

Generally, many of the foreign exchange policies in 1397 have only led to the distribution of significant economic rents. The foreign exchange policy-maker is dissatisfied with the supplied amount of earnings in foreign exchanges from non-oil exports in NIMA, while the reductions in oil and non-oil exports are expected for the next year. Therefore, preserving the current foreign reserves is essential.

78.0 percent, compared to 07/1396. Statistics on monetary base components in these two months and in different quarters of 1396 and 1397 are presented in Table 8.

Table 8- Monetary Base Components (end of period – IRR trillions)

	1396					1397			07/1397 to 07/1396	
	Q1	Q2	07/1396	Q3	Q4	Q1	Q2	07/1397	Growth Rate (percent)	Share in Growth (percentage points)
<b>Monetary Base</b>	<b>1,851.9</b>	<b>1,964.9</b>	<b>1,963.5</b>	<b>1,995.0</b>	<b>2,139.8</b>	<b>2,186.6</b>	<b>2,345.1</b>	<b>2,365.5</b>	<b>20.5</b>	<b>20.5</b>
CBI Net Foreign Assets	1,853.9	1,874.4	1,863.8	1,913.8	2,159.8	2,377.0	2,364.5	2,293.3	23.0	21.9
CBI Net Claims on Public Sector	282.0	292.2	268.5	279.9	55.1	82.8	82.4	59.0	-78.0	-10.7
CBI Claims on Banks	1,013.7	1,097.1	1,123.8	1,130.7	1,320.3	1,397.1	1,506.5	1,605.4	42.8	24.5
Other Items (Net)	-1,297.7	-1,298.8	-1,292.6	-1,329.4	-1,395.4	-1,670.3	-1,608.3	-1,592.2	23.2	-15.2

Source: Central Bank of Iran, Selected Economic Indicators, various issues

According to CBI statistics, CBI claims on banks were the main driver of the growth in monetary base in 07/1397, with 24.5 percentage points share in growth, while the lowest share in growth was recorded for net other items, with negative 15.2 percentage points. In 1397, the banks' monthly overdraft from the CBI was roughly IRR41 trillion. Since this is regarded as one of the costliest methods of financing, the banks in a desired model prefer to have the least amount of overdraft and use a number of alternatives instead, such as sale of bank's assets, interbank borrowing, financing through the capital market, and issuing new certificates of deposit. This is why very high interest rates are set on overdraft from CBI funds. However, this penalty has not been sufficient by itself for controlling the volume of overdraft, and strict supervisory measures of the CBI and the deterioration of the bank's credit among agents in the capital market were more influential in controlling the use of CBI funds by the banks.

CBI claims on banks in the first seven months of 1397 rose by 21.6 percent, while this growth rate for 1396 had amounted to only 12 percent. This indicates that the frequency of asking for CBI funds was much higher for banks in the first seven months of 1397 than the same period a year earlier. CBI claims on banks in the period under review climbed by IRR290 trillion, which is IRR165 trillion above the increase in the first seven months of 1396.

On the other hand, the annual growth rate of liquidity in 07/1397 reached 20.7 percent. This was the fourth consecutive month in which this annual growth rate stayed at around 20 percent. The downward trend of liquidity growth rate started in 04/1395

and dropped from 30 percent to 20 percent in 02/1397, but has fluctuated around this level during the last five months. In 07/1397, liquidity grew by IRR214.7 trillion. The liquidity growth rate in the first seven months of 1397 was 10.7 percent, 1.2 percentage points below that in the same period a year earlier. Out of IRR16,938.4 trillion of liquidity at the end of 07/1397, IRR2,420.1 trillion (14.3 percent) was in the form of money and the rest was quasi-money. The share for money at the end of the preceding month was 14.6 percent.

Unlike previous months, total amount of money in 07/1397 decreased, with a growth rate of negative 0.7 percent. This growth rate had amounted to 7.8 percent in 05/1397 and 5.2 percent in 06/1397. The point-to-point growth rate of money in 07/1396 was 47.7 percent, 2.9 percentage points below that in the preceding month. One of the contributors to the negative growth rate of money and the decrease in money demand was the start of a downward trend in USD/IRR exchange rate from 07/1397, when the investors might return their funds to the money market in the form of non-sight deposits. The amount of bank deposits at the end of 07/1397 stood at IRR16,490 trillion. In 1396, contrary to the first seven months of 1397, the majority of term deposits were long-term deposits. At the end of 07/1397, 42 percent of term deposits for non-public entities were long-term deposits, 6 percentage points below the corresponding amount at the end of the year 1396. Table 9 demonstrates statistics on M2 money multiplier and liquidity components in different quarters of 1396 and 1397, as well as in the first month of fall in these two years.

Table 9- M2 Money Multiplier and Liquidity Components (end of period – IRR trillions)

	1396					1397			04/1397 to 04/1396	
	Q1	Q2	07/1396	Q3	Q4	Q1	Q2	07/1397	Growth Rate (percent)	Share in Growth (percentage points)
<b>Liquidity</b>	<b>13,149.1</b>	<b>13,899.5</b>	<b>14,030.5</b>	<b>14,450.1</b>	<b>15,299.8</b>	<b>15,827.5</b>	<b>16,723.7</b>	<b>16,938.4</b>	<b>20.7</b>	<b>20.7</b>
Money	1,647.1	1,682.4	1,638.0	1,734.4	1,946.7	2,059.5	2,436.7	2,420.1	47.7	5.6
Notes and Coins with the Public	340.1	344.7	343.6	348.6	442.7	406.0	445.0	452.2	31.6	0.8
Sight Deposits	1,307.0	1,337.7	1,294.4	1,385.8	1,504.0	1,653.5	1,991.7	1,967.9	52.0	4.8
Quasi-Money	11,502.0	12,217.1	12,392.5	12,715.7	13,353.1	13,768.0	14,287.0	14,518.3	17.2	15.1
M2 Money Multiplier	7.1	7.1	7.1	7.2	7.2	7.2	7.1	7.2	1.4	-

Source: Central Bank of Iran, Selected Economic Indicators, various issues

The balance of deposits in both IRR and foreign currencies stood at IRR18,058.0 trillion at the end of 06/1397, indicating 27.2 percent rise from a month earlier and 9.7 percent increase from the end of 1396. In 06/1397, the balance of extended facilities amounted to IRR13,638.0 trillion, increasing 27.8 percent from the preceding month. The ratio of extended facilities to deposits (less required reserves) rose by 0.3 percentage points compared to 06/1396, and fell by 1.1 percentage points compared to the end of 1396, to reach 84.3 percent in 06/1397.

According to the latest report of Shaparak<sup>3</sup>, the value of total

transactions in 06/1397 expanded by 3.5 percent compared to a month earlier. Considering the 1.5 percent increase in liquidity during the period under review, the ratio of total value of transactions to liquidity was 14.6 percent, 2.0 percentage points above that in 05/1397.<sup>4</sup> Moreover, in 08/1397, more than 1.7 billion transactions were processed valued at IRR14.4 trillion at 1395 constant prices, which indicates 2.9 percent drop in number and 18.3 percent real growth in value, compared to the preceding month.

## 6. Government Budget and Fiscal Position

### Performance of the First Seven Months of 1397

Tax revenues grew by 14.2 percent in the first seven months of 1397 due to the significant economic growth in 1395 and 1396, while this figure in the same period of the preceding year was only 2.7 percent. However, tax revenues during the first seven months of 1397 were 28.5 percent below the legislated figure in the Budget Law. Other current revenues decreased by 25.8 percent, only amounted to 35.3 percent of the legislated figure. In contrast to the low realization of current government revenues, current government expenditures during this period grew by 20.8 percent, equivalent to 86.3 percent of the legislated figure. Thus, the operational balance deficit in the first seven months of 1397 recorded significant growth of 45.6 percent and was even 75.3 percent higher than the legislated figure in the Budget Law.

The net disposal of non-financial assets in the period under review was 25.8 percent higher than the amount in the same period of the preceding year and 45.6 percent above the legislated figure in the Budget Law. Despite the start of a new round of US sanctions, oil revenues, that account for much of the disposal of non-financial assets, rose by 55.1 percent in the first seven months of the year and covered 121.8 percent of the legislated figure in the Budget Law. A part of this increase in oil revenues was due to the rise of USD/IRR official exchange rate to 42,000 and the other part was corresponding to the increase in oil sales in 1397Q1, before the start of oil sanctions and the rise in world oil prices. The growth rate of oil revenues in this quarter recorded 72.6 percent, while it has gradually declined. Unlike the usual practice of past years, development expenditures also increased sharply in the first quarter of the year and slowed down afterwards. The acquisition

of non-financial assets (development expenditures) grew by 122.2 percent in the first seven months of 1397, although an insignificant growth rate is expected for the whole year.

Total government revenues in the period under review rose by 23.1 percent compared to the same period a year earlier and equaled 77.5 percent of the legislated figure in the Budget Law. Total government expenditures in the same period increased by 31.2 percent, covering 89.1 percent of the legislated figure. Accordingly, the budget deficit reached IRR391.4 trillion, 74.8 percent up from that in a year earlier and 105.1 percent up from the legislated figure in the Budget Law. The share of budget deficit in total general sources, which was envisaged 9.1 percent, increased to 21.6 percent in performance.

During the first seven months of 1397, the disposal of financial assets rose by 42.7 percent, approximately 33.5 percent above the legislated figure. The sale of state-owned companies shares in the disposal of financial assets has been continually decreasing in recent years and the issuance of government debt securities has been the main contributor to the rise in the disposal of financial assets whose repurchase will impose high burden on the government in coming years. During the first seven months of the year, the disposal of financial assets amounted to IRR498.2 trillion, out of which IRR222.0 trillion was related to the issuance of various Islamic debt securities: IRR59.4 trillion for financing current expenditures, IRR153.9 trillion for financing development expenditures, and IRR8.7 trillion in cash. In the same period, the acquisition of financial assets - settlement of government's previous debts - reached IRR106.8 trillion and is expected to almost double at the end of the year. Table 10 exhibits the government fiscal performance in 1397.

3. Electronic Card Payment Network System (SHAPARAK) is a platform which brings together payment service providers (PSP) and their POS terminals in a highly integrated system and, by advocating central management and monitoring functionality, will promote efficiency, effectiveness and security of card payment network.

4. The effectiveness of electronic payment industry on easing economic transactions, which is the share of liquidity paid electronically, is represented by the ratio of total value of transactions to liquidity.

Table 10- Government Fiscal Performance in 1397 (IRR trillions - percent)

	1397						Performance of the First Seven Months of 1397 Compared to the Legislated Figures
	Q1		Q2		First Seven Months		
	Amount	Growth	Amount	Growth	Amount	Growth	
<b>Revenues</b>	<b>590.6</b>	<b>38.6</b>	<b>676.1</b>	<b>14.5</b>	<b>1,485.1</b>	<b>23.1</b>	<b>77.5</b>
Tax Revenues	225.9	24.2	277.5	11.3	600.9	14.2	71.5
Other Current Revenues	38.3	-29.8	92.9	13.2	154.6	-25.8	35.3
Oil Revenues	326.0	72.6	304.6	18.2	727.8	55.1	121.8
Other Disposal of Non-Financial Assets	0.4	-50.5	1.1	-21.0	1.8	-29.8	4.6
<b>Expenditures</b>	<b>880.7</b>	<b>46.6</b>	<b>758.3</b>	<b>27.0</b>	<b>1,876.4</b>	<b>31.2</b>	<b>89.1</b>
Current Expenditures	588.1	7.2	721.8	37.2	1,501.7	20.8	86.3
Development Expenditures	226.7	2,649.2	39.7	-43.2	313.8	122.2	85.5
<b>Budget Balance</b>	<b>-290.1</b>	<b>66.0</b>	<b>-82.2</b>	<b>1,183.4</b>	<b>-391.4</b>	<b>74.8</b>	<b>205.1</b>
Operating Balance	-389.8	9.4	-339.0	73.3	-807.2	45.6	175.3
Net Disposal of Non-Financial Assets	99.7	-45.0	256.8	35.8	415.7	25.8	154.2
<b>Disposal of Financial Assets</b>	<b>290.1</b>	<b>57.3</b>	<b>129.2</b>	<b>87.5</b>	<b>498.2</b>	<b>42.7</b>	<b>133.5</b>
<b>Acquisition of Financial Assets</b>	<b>0.0</b>	<b>-100.0</b>	<b>47.0</b>	<b>-24.7</b>	<b>106.8</b>	<b>-14.8</b>	<b>58.6</b>

Source: Central Bank of Iran, Selected Economic Indicators, various issues

Note: The difference between the sum of current and development expenditures and total expenditures is due to the fact that revolving funds are not settled.

In the subgroup of tax revenues, “tax on legal entities” and “tax on goods and services” usually account for the highest share in “direct tax” and “indirect tax” categories, respectively. Tax on legal entities fell by 11.1 percent in the first seven months of the year, translating deep depression in economic firms, given the high expected inflation rate. However, thanks to the significant increase in income tax and wealth tax revenues, total direct tax

revenues recorded a positive growth of 1.1 percent. In contrast, revenues from indirect taxes rose by 27.1 percent. The 53.5 percent increase in import tax revenues during this period due to the USD/IRR exchange rate depreciation has been one of the major factors in the significant growth of indirect tax revenues. Table 11 shows the components of government tax revenues in the first seven months of 1396 and 1397.

Table 11- Components of Tax Revenues (IRR trillions - percent)

	First Seven Months of 1396			First Seven Months of 1397		
	Amount	Share	Growth	Amount	Share	Growth
<b>Tax Revenues</b>	<b>526.4</b>	<b>100.0</b>	<b>2.7</b>	<b>600.9</b>	<b>100.0</b>	<b>14.2</b>
<b>Direct</b>	<b>261.3</b>	<b>49.6</b>	<b>-5.7</b>	<b>264.1</b>	<b>43.9</b>	<b>1.1</b>
Legal Entities	156.5	29.7	-12.5	139.1	23.1	-11.1
On Income	89.7	17.0	7.0	104.5	17.4	16.5
On Wealth	15.1	2.9	4.5	20.5	3.4	35.6
<b>Indirect</b>	<b>265.1</b>	<b>50.4</b>	<b>12.6</b>	<b>336.8</b>	<b>56.1</b>	<b>27.1</b>
On Imports	54.8	10.4	11.0	84.0	14.0	53.4
On Goods and Services	210.3	40.0	13.1	252.8	42.1	20.2
On Value Added	146.8	27.9	27.9	161.8	26.9	10.2

Source: Central Bank of Iran, Selected Economic Indicators, various issues

## The Budget Bill of 1398

The figures in the Budget Bill indicate smaller size of the government and larger size of state-owned companies compared to those in 1397 Budget Law. The government budget in 1398, that consists of state-owned companies’ budget and government’s general budget, rose by 39.3 percent from that of 1397, which is not surprising taking the expected inflation rate into account. The budget of state-owned companies has risen by 51.9 percent, while the government’s general budget increased by only 8.0 percent. Government’s general budget is made up of “general sources and uses” and “dedicated revenues and expenditures”. Dedicated revenues are those generated and simultaneously spent by

government institutions. In other words, dedicated revenues are not transferred to the treasury to be reallocated. Hence, general sources are directly in the hands of government and treasury that consist of current revenues (mainly tax revenues), disposal of non-financial assets (mainly oil exports proceeds) and disposal of financial assets (mainly sales of debt securities). The treasury spends these revenues in three categories: current expenditures (mainly compensation of government employees and payments to pension funds), acquisition of non-financial assets (development expenditures), and acquisition of financial assets (settlement of previous debts). Table 12 exhibits an overview of 1398 Budget Bill.

Table 12- Overview of 1398 Budget Bill (IRR trillions - percent)

	Sources				Uses		
	1398 Budget Bill	Growth Rate Compared to 1397 Budget Law	Growth Rate Compared to 1397 Budget Bill		1398 Budget Bill	Growth Rate Compared to 1397 Budget Law	Growth Rate Compared to 1397 Budget Bill
Revenues	2,087	-3.5	7.9	Expenditures	3,207	9.1	16.0
Disposal of Non-Financial Assets	1,480	37.6	38.9	Acquisition of Non-Financial Assets	620	0.0	2.6
Disposal of Financial Assets	510	-19.1	-25.1	Acquisition of Financial Assets	250	-18.8	-19.8
<b>Total General Sources</b>	<b>4,077</b>	<b>5.4</b>	<b>10.8</b>	<b>Total General Uses</b>	<b>4,077</b>	<b>5.4</b>	<b>10.8</b>
Dedicated Revenues	709	24.2	24.7	From Dedicated Revenues	709	24.2	24.7
<b>Government General Budget Sources</b>	<b>4,786</b>	<b>8.0</b>	<b>12.6</b>	<b>Government General Budget Uses</b>	<b>4,786</b>	<b>8.0</b>	<b>12.6</b>
State-Owned Companies' Sources	12,748	51.9	56.6	State-Owned Companies' Uses	12,748	51.9	56.6
<b>Sources of Budget</b>	<b>17,032</b>	<b>39.3</b>	<b>42.5</b>	<b>Uses of Budget</b>	<b>17,032</b>	<b>39.3</b>	<b>42.5</b>

Source: 1398 and 1397 Budget Bills; 1397 Budget law

In the Budget Bill of 1398, the total general sources and uses are IRR4,077 trillion, 5.4 percent above the Budget Law of 1397. The government, nevertheless, has considered the license to add up to IRR400 trillion to its general uses in the "second ceiling", if it receives more general sources, especially from the surplus of oil revenues and withdrawal from the National Development Fund (NDF). This method of budgeting is imprecise and non-transparent. The correct method is providing amendments, after receiving more sources than those predicted in the Budget Law, over the course of the year. Moreover, according to this license, the government has not only set the share of the NDF 14 percentage points less than the approved amount in the Sixth Development Plan Law, but also has considered more withdrawals from the NDF. Inaccurately, IRR77.5 trillion of expenditures in the second ceiling are related to the repayment of government securities principal and IRR6.5 trillion to the government securities and foreign loans interest. This is on top of the IRR192.3 trillion for repayment of government securities principal, IRR62 trillion for repayment of government securities interest and IRR50 trillion for rolling over the matured securities by issuing new securities that are considered in the first ceiling of the Budget Bill. Therefore, the financial burden of repayment of government securities in the first ceiling of the Budget Bill of 1398 is IRR304 trillion, below the figure in 1397 Budget Law (IRR350 trillion). There has been no reason for reducing the financial burden of repayment of government securities in 1398 and, in fact, corresponding figures in the second ceiling should be added to the first ceiling. In other words, the government has relied to the NDF for repayment of IRR84 trillion of government securities principal and interest.

The disposal of non-financial assets has risen by 37.6 percent compared to 1397 Budget Law, not due to expecting an increase in oil exports, but owing to a reduced share of the NDF in oil exports. The NDF's share in oil exports in 1397 Budget Law was 32 percent, while it has fallen to 20 percent in the Budget Bill of 1398. The disposal of non-financial assets has been predicted to reach IRR1,480 trillion, out of which more than IRR1,425 trillion

is related to oil revenues. The other components are IRR45 trillion for the disposal of moveable and immovable assets and IRR10 trillion for the disposal of development projects that are not usually realized in practice.

In the Budget Bill of 1398, the government has implicitly considered the export of oil and petroleum products at about 1.5 million bpd, the oil price at about USD54 per barrel and the value of gas exports at USD3.45 billion. According to these assumptions, the oil revenues have been estimated to reach USD24.5 billion. A portion of that (USD14 billion) will be converted into rials by USD/IRR exchange rate of 42,000 for importing essential goods, while another part (USD10.5 billion) will be converted according to the current rate of NIMA at USD/IRR exchange rate of 80,000. Therefore, the weighted average USD/IRR exchange rate of oil revenues will be almost 58,000. According to a number of international organizations, the estimated oil price in the Budget Bill seems to be realistic, while the level of oil exports may be overestimated. The Islamic Parliament Research Center has predicted oil exports to record almost one million bpd. In this situation, if everything else remain unchanged, reaching IRR1,425 trillion for oil revenues in the Bill will require a weighted average of USD/IRR exchange rate of almost 82,000. Therefore, after allocating USD14 billion for import of essential goods at USD/IRR exchange rate of 42,000, other oil revenues must be exchanged at the exchange rate of 245,000, more than twice the current rate in the free market.

However, the foreign exchange proceeds due to oil exports cannot be easily transferred to the country and some of that will be blocked in foreign accounts of the CBI. The fact that government spending is backed by these reserves is equivalent to borrowing from the CBI, using blocked oil revenues as collateral.

It seems the government is planning to withdrawal from various unlikely sources and hiding a part by overestimating oil revenues, instead of reducing expenditures in face of the contraction of oil revenues. Table 13 exhibits components of total general sources and uses in 1398 Budget Bill.

Table 13- Components of Total General Sources and Uses in 1398 Budget Bill (IRR trillions - percent)

Sources	1398 Budget Bill	Growth Rate in Comparison to 1397 Budget Law	Growth Rate in Comparison to 1397 Budget Bill	Uses	1398 Budget Bill	Growth Rate in Comparison to 1397 Budget Law	Growth Rate in Comparison to 1397 Budget Bill
Revenues (general)	2,086.8	-3.5	7.9	Expenditures (current)	3,206.9	9.1	16.0
Tax	1,535.7	8.1	19.3	Compensation of Employees	952.3	29.2	-10.4
Proceeds of State-Owned Properties	252.6	-33.0	7.6	Use of Goods and Services	233.8	-11.7	-45.0
Proceeds of Sale of Goods and Services	97.7	-11.1	-2.3	Cost of Properties	0.2	-86.0	-85.7
Proceeds of Fines and Damage	50.3	-34.5	-34.5	Subsidies	116.4	24.0	46.9
Other	150.5	-15.1	-36.1	Grants	64.7	-15.7	2.5
				Social Welfare	1,225.9	20.0	25.0
				Other	613.7	-17.5	302.5
<b>Operating Balance</b>					<b>-1,120.2</b>	<b>44.0</b>	<b>34.9</b>
Disposal of Non-Financial Assets	1,480.4	37.6	38.9	Acquisition of Non-Financial Assets (Development Expenditures)	620.2	0.0	2.6
Receipts from Crude Oil and Oil Products	1,425.4	41.1	41.1	Construction	456.4	1.2	5.3
Receipts from Sale or Disposal of Properties	45.0	76.5	190.3	Machinery and Equipment	81.0	2.9	-25.0
Receipts from Disposal of Development Projects	10.0	-75.0	-75.0	Other Fixed Assets	1.0	13.1	13.1
				Inventory Use	0.0	-100.0	-100.0
				Precious Items	0.6	713.0	713.0
				Land	3.0	22.1	23.0
				Other Non-Produced Assets	78.3	-9.7	32.1
<b>Net Disposal of Non-financial Assets</b>					<b>860.2</b>	<b>88.8</b>	<b>86.5</b>
Disposal of Financial Assets	510.0	-19.1	-25.1	Acquisition of Financial Assets	250.0	-18.8	-19.8
Sale of Islamic Securities	440.0	14.3	14.3	Credit Related to Disposal of Stocks	26.7	-56.6	-59.3
Use of Foreign Loans	0.5	-85.9	-85.9	Principal of Islamic Securities Repayment	192.3	-16.4	-16.4
Principal of Loans Receipt	21.3	-4.8	71.8	Principal of Bank Loans Repayment	1.6	0.0	0.0
Disposal of State-Owned Companies	36.0	-46.7	-41.5	Unpaid Obligations from Previous Years	1.1	-50.9	-50.9
Last Year's Payments Return	8.2	74.4	74.4	Principal of Foreign Loans Repayment	28.3	126.8	126.8
Use of National Development Fund	0.0	-100.0	-100.0				
Other	4.0	14.3	14.3				
<b>Net Disposal of Financial Assets</b>					<b>260.0</b>	<b>-19.4</b>	<b>-29.5</b>

Source: 1398 and 1397 Budget Bill; 1397 Budget Law

Despite the 3.5-percent decline in current revenues in 1398 Budget Bill compared to 1397 Budget Law, current expenditures have recorded a 9.1-percent increase backed by expansion in oil revenues which has led to a 44-percent increase in operational balance deficit. The compensation of employees has grown by 29.2 percent, while the expected inflation is increasing and the government has announced a 20-percent expansion in government employees' salaries and wages. According to the Islamic Parliament Research Center estimates, the government

must pay IRR1,740 trillion as salary and wage to the employees and pensioners in 1397 and the 20-percent growth rate brings it to IRR2,088 trillion, equal to 65.1 percent of total current expenditures in 1398 Budget Bill.

In 1398 Budget Bill and 1397 Budget Law, the figure for social welfare is larger than that of compensation of employees, while the reverse held true in past years. More than half of IRR1,225.9 trillion for social welfare in 1398 Budget Bill is related to



Civil Servants Pension Organization and Military Social Security Organization. The imposed cost on the government due to the bankruptcy of pension funds is bound to exceed the compensation of employees in next years. Some other important organizations that benefit from the social welfare budget include Iran Health Insurance Organization by IRR120.3 trillion, Imam Khomeini Relief Foundation by IRR40.1 trillion, State Welfare Organization of Iran by IRR25.9 trillion, and Services Center of Seminaries by IRR10.4 trillion.

Despite the increase in oil revenues due to the reduction in the share of the NDF, the government has not considered an increase in development expenditures to cover part of its significant

operating balance deficit. Thus, the capital balance has grown by 88.8 percent in 1398 Budget Bill compared to the 1397 Budget Law. In order to solve the problem of semi-finished development projects, the government has decided to stop some old projects and impose restrictions for provincial new ones.

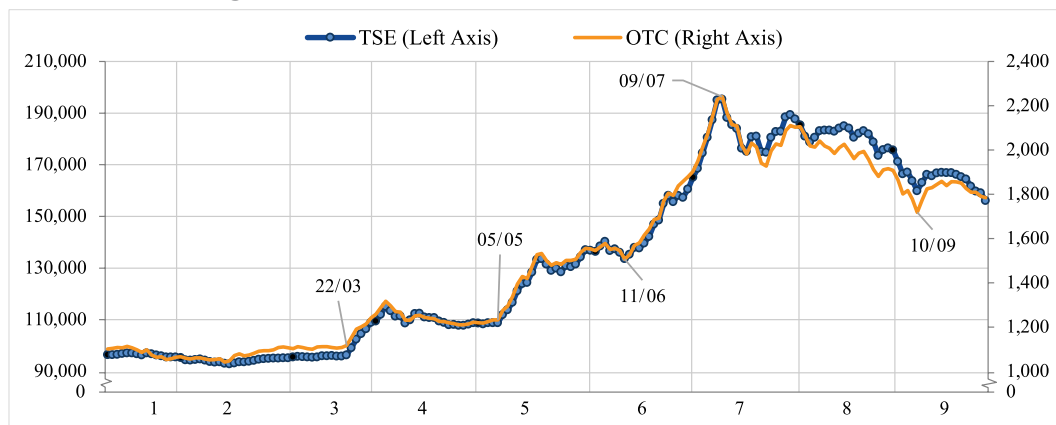
Finally, it is important to mention that the government has made the Budget Bill in general and the financial balance in particular unclear and inaccurate through creating the second ceiling and moving some definitive expenditures into that, decreasing the share of the NDF from oil exports, and acquiring permits for withdrawal from this Fund without a clear cap.

## 7. Capital Market

The overall index of Tehran Stock Exchange (TSE) recorded 156,083 at the end of 1397Q3, although it had experienced a high of 195,480 at the beginning of this quarter. Reaching this hike, the index witnessed a rare growth rate of nearly 108 percent in less than four months, contrary to its downside erratic movement afterwards. A one-week increasing trend around the end of 07/1397, roughly concurrent with the new US sanctions, raised hopes for continuing a constant rise and reaching new records. The index, nevertheless, just fluctuated wildly until the end of

08/1397, when it started to plummet suddenly and registered a negative growth rate over the whole season. Likewise, the overall index of Over the Counter (OTC) hit a peak of 2,241 in the early days of 07/1397 and plunged to a low of 1,718 by early 09/1397, recording just over 23 percent reduction in nearly a mere two months. This index closed 1397Q3 at 1,785, 6.2 percent lower than the beginning of the quarter. Figure 5 illustrates the movements of TSE and OTC overall indices over the first nine months of 1397.

Figure 5 – TSE and OTC Overall Indices over the First Nine Months of 1397

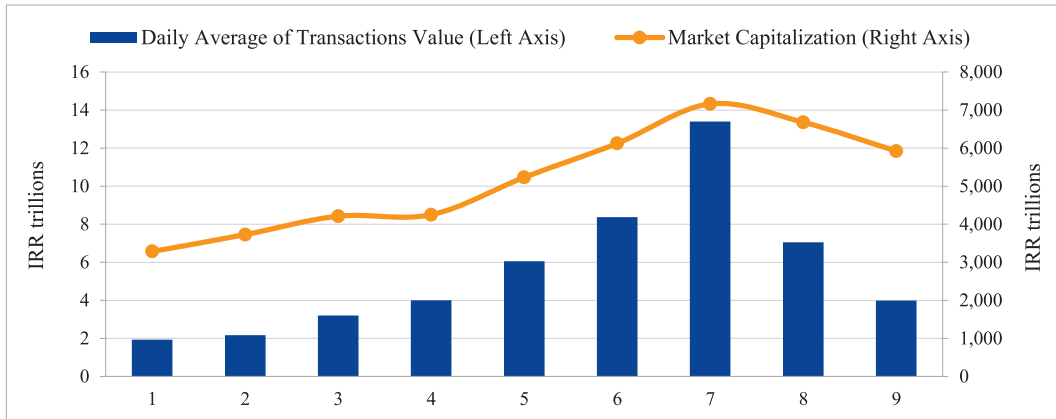


Sources: Official websites of the TSE (<http://new.tse.ir>) and the OTC (<http://ifb.ir>)

Figure 6 indicates the developments in the total value of traded shares and preemptive rights, as well as the market value of the TSE. According to this Figure, the highest value of transactions was registered in 07/1397, averaging IRR13.4 trillion per working day, followed by two remarkable declines of 47.0 percent and 43.0 percent, respectively, in the last two months of the quarter. Such a downward trend was also evident through both volume

and number of transactions, implying a reduction of speculative activities in the TSE. The reduction in USD/IRR exchange rate at the end of 1397Q3 compared to the peak of 07/1397 might be one of the main contributors to the mentioned declines. In consequence, the market value of the TSE was adversely affected and declined to IRR5,924 trillion at the end of 1397Q3.

Figure 6 – Market Value and Monthly Value of Transactions in the TSE



Sources: Tehran Stock Exchange, Report of the performance of securities market, 09/1397



## **Middle East Bank Headquarters**

No. 2, 5<sup>th</sup> St., Ahmad Qasir (Bucharest) Ave., Tehran, Iran

Tel: (+98 21) 4217 8000  
[www.middleeastbank.ir](http://www.middleeastbank.ir)

Fax: (+98 21) 8870 1095  
[info@middleeastbank.ir](mailto:info@middleeastbank.ir)